

**The Asset Management Program Can Be
Successful Through Active Executive
Monitoring and Oversight**

November 2000

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

November 24, 2000

MEMORANDUM FOR COMMISSIONER ROSSOTTI

A handwritten signature in cursive script, reading "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Asset Management Program Can Be
Successful Through Active Executive Monitoring and Oversight

This report presents the results of our review of the Internal Revenue Service (IRS) Asset Management Program. The objective of the review was to evaluate asset management in the IRS by reviewing plans and procedures to properly account for property and equipment (P&E).

In summary, we found that the IRS has taken action to address longstanding problems with its systems and controls over P&E. To improve upon these actions, we recommended that the IRS assign one senior executive responsibility for asset management, resolve differences with the interpretation or application of accounting standards and policies, and timely implement commitments in a Memorandum of Understanding between affected IRS offices.

IRS management disagrees with most of our recommendations. A brief description of their disagreement is included in the appropriate sections within the report, and their complete response is included in Appendix V. Where appropriate, we made suggested changes to the report and included additional comments to clarify our position on those recommendations where we have a difference of opinion. In some instances, IRS management has changed their course of action since the completion of our fieldwork in March 2000, and we have commented on the impact of those changes on our recommendations. We continue to believe that our recommendations will assist IRS in coming to terms with the longstanding issue of P&E accountability and control, and urge the IRS to consider them as it continues to implement changes to the P&E procedures and systems.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions, or your staff may call Maurice S. Moody, Associate Inspector General (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

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Executive Summary

The Internal Revenue Service (IRS) has had longstanding problems with its systems and controls over property and equipment (P&E). The General Accounting Office (GAO) has reported on these weaknesses, most recently in its report on the IRS' Fiscal Year (FY) 1999 financial statements.¹ The IRS has identified P&E as a material weakness since 1983 as part of the Federal Managers' Financial Integrity Act of 1982 (FMFIA)² process.

The IRS has taken action to address these problems. For example, the IRS Commissioner designated the Chief Information Officer (CIO) as responsible for controlling and accounting for all Automated Data Processing (ADP) equipment and software. The CIO organization conducted a comprehensive inventory to ensure that all critical systems were identified and made Year 2000 compliant. Additionally, the Chief Financial Officer (CFO) engaged an outside consultant to conduct a statistical sample to derive an estimate for the September 30, 1999, P&E balance. Moreover, the CFO, CIO, and Chief, Agency-Wide Shared Services (AWSS), entered into a Memorandum of Understanding (MOU) listing actions each was responsible for in maintaining control over capital assets for purchases after September 30, 1999.

The overall objective of our review was to evaluate asset management in the IRS, taking into consideration public and private sector practices, accounting standards and principles, and guidance issued by various government entities.

Results

While the IRS has taken positive steps to improve P&E inventory, continued involvement by senior management is necessary to sustain a reliable inventory figure and to address fundamental issues that will have an impact on the long-term viability of an integrated financial management system. The IRS is at risk of having spent \$1.5 million for a FY 1999 ending P&E balance that was reliable only on September 30, 1999. To minimize this risk and to improve the value of P&E financial reporting, the IRS should assign responsibility for P&E to one senior executive, resolve differences with the

¹ GAO/AIMD-00-76 *Financial Audit: IRS' Fiscal Year 1999 Financial Statements*.

² 31 U.S.C §§ 1105-1106, 1113, and 3512 (1994).

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application of accounting standards and policies, and timely implement commitments listed in the MOU.

Responsibility for Asset Management Should Be Assigned to One Senior Executive

Several components of the IRS have responsibility for P&E accountability and financial reporting, including the CFO, CIO, and AWSS organizations. Further, accountability for and control over assets is vested throughout the management hierarchy as part of a manager's operational duties. The Chief Financial Officer's Act of 1990³ designates agency CFOs as responsible for directing, managing, and providing policy guidance and oversight of financial management operations. These responsibilities include the implementation of agency asset management systems for property and inventory management and control. In the IRS, the CIO has sole responsibility for ownership and control of all ADP property, while financial information is obtained from a number of other functions. Also, neither the CIO nor CFO have authority over the resources provided by other functions to ensure the accuracy of the inventory databases. Because of this division of responsibilities, the IRS may continue to experience difficulties in maintaining an accurate and reliable inventory system. We are recommending the IRS Commissioner assign one senior executive the responsibility for overseeing the IRS' asset management program.

Differences with the Interpretation or Application of Accounting Standards and Policies Should Be Resolved

Considerable debate has been undertaken in the federal financial community concerning capitalization thresholds, working capital fund (WCF) assets, and leasehold improvements. Some IRS policies and procedures on these issues differ with accounting standards and definitions, general business practices, and other guidance. For example, the IRS in FY 1998 used a \$50,000 threshold for capitalizing assets, a policy that is consistent with Department of the Treasury guidance but does not necessarily coincide with business practices in private sector entities. Additional factors that affect this issue and should be considered are the concept of materiality and the desire for accountability and control of assets from a stewardship standpoint, as compared to expensing or capitalizing assets from a financial reporting aspect.

³ Chief Financial Officer's Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838. The Department of the Treasury is one of the agencies listed in the Act.

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A complete and accurate inventory system would allow the IRS to establish a capitalization threshold based on a sound analysis, account for WCF assets, and track leasehold improvements.

Memorandum of Understanding Commitments Should Be Implemented Timely

The IRS recognized that sustaining the FY 1999 P&E ending inventory figure was crucial for establishing a baseline for future valuations. In this regard, the IRS developed an MOU with the CFO, CIO, and Chief, AWSS, to establish interim procedures to be used until an integrated financial system was in place. While the IRS continues its efforts to integrate its financial system, existing systems can allow for the interim processes to be successful. With an updated and maintained inventory system, the IRS can achieve success in sustaining the P&E figure. Achieving this goal requires a diligent effort to timely deliver on commitments outlined in the MOU. The CFO, CIO, and AWSS organizations each had several action items to complete, many of which were interdependent. However, substantial implementation of the MOU had not occurred at the conclusion of our review. Accordingly, the IRS needs to timely act on several key provisions, including accounting for all purchases made after September 30, 1999, defining exception report parameters, and committing resources to P&E activities.

Summary of Recommendations

To have an effective asset management program, the IRS should assign overall program responsibility to one senior executive with the authority to direct appropriate resources to accomplish both accountability and control of assets and financial reporting. The IRS should also use data from existing systems, after the data are updated and validated, to determine a capitalization threshold that is consistent with accounting standards and sound business practices. IRS management in the CFO, CIO, and AWSS organizations should aggressively pursue action on the MOU to stabilize the P&E inventory process and increase the likelihood of a sustainable inventory figure.

Management's Response: The IRS disagreed with most of our recommendations. In November 1999, the IRS gave the CIO the authority to perform those functions having Servicewide impact and relating to the acquisition of Information Technology (IT) and the management of information resources, and does not plan to designate another official responsible. There is a fundamental disagreement between the Department of the Treasury and the GAO about the appropriate level for capitalization threshold. The IRS followed Treasury policy; however, the capitalization threshold is no longer an issue

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since the IRS is adopting a pooling procedure. Under this procedure, the cost or value of an asset is not recorded in the inventory. Rather, the acquisition costs by year for each selected class of assets will be accumulated in the accounting records. When capitalization thresholds are re-evaluated, the IRS will consult with interested stakeholders. A subcommittee has been working on the property control material weakness, and as the work progressed, senior officials recognized the need to rework the MOU, which was recently completed.

Management's complete response to the draft report is included in Appendix V.

Office of Audit Comments: The CIO does not have the authority to resolve conflicts that may arise between the CIO, CFO, Chief AWSS, and other functional organizations relating to the recording and control of P&E. Also, the CIO is not responsible for non-IT assets. The IRS is relying on all levels of management to assure that the policies for managing P&E are properly carried out. This is basically the same policy that the IRS followed in the past that resulted in inadequate control and accountability over P&E. We agree that capitalization thresholds do not apply to the pooling concept; however, at the completion of our fieldwork in March 2000, the pooling concept had not been adopted. At that time, IRS management was planning on recording the cost of FY 2000 purchases in the inventory systems and, accordingly, the capitalization threshold would have been an issue. Where appropriate in this report, we have included additional comments on management's concerns with our recommendations on WCF assets, leasehold improvements, and the MOU implementation.

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Objective and Scope

The overall objective of this review was to evaluate asset management in the IRS.

The overall objective of this review was to evaluate asset management in the Internal Revenue Service (IRS). In particular, we evaluated IRS plans and procedures to properly account for property and equipment (P&E). We also determined whether effective procedures and controls were established to ensure the P&E balance sheet figures for the Fiscal Year (FY) 1999 financial statements will be sustained through FY 2000 and beyond. The audit was performed in the office of the Chief Financial Officer (CFO) in Bethesda, Maryland, during the period December 1999 through March 2000.

This audit was performed in accordance with *Government Auditing Standards*. Details of our audit objective, scope, and methodology are presented in Appendix I. Major contributors to this report are listed in Appendix II.

Background

Every year since 1983, the IRS has reported under the Federal Managers' Financial Integrity Act of 1982 (FMFIA)¹ that it does not have a reliable system of accounting for property; therefore, it is unable to determine if property is being properly used or misappropriated.

The Chief Financial Officer's Act of 1990² established the responsibility for the government to report on the financial condition of each agency and prepare consolidated government-wide financial statements.

In March 1999, the General Accounting Office (GAO) issued a qualified opinion on the IRS' FY 1998 balance

¹ 31 U.S.C. §§ 1105-1106, 1113, and 3512 (1994).

² Pub. L. No. 101-576, 104 Stat. 2838.

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Over the past 2 years, the IRS spent \$1.5 million for assistance in resolving P&E issues.

sheet because it was unable to obtain, through substantive audit procedures, reasonable assurance that IRS balances were reliable. In part, the GAO found evidence to conclude that P&E were likely materially understated.

In response to the GAO's qualified opinion and the recurring material weaknesses in controlling and maintaining accurate P&E inventories, an outside consultant was engaged to address inventory concerns. Over the past 2 years, the IRS spent \$1.5 million for assistance in resolving P&E weaknesses. Part of the contract provided for the vendor to identify and value IRS assets for use in a statistical sampling process. These efforts resulted in the IRS receiving a favorable opinion for the ending P&E inventory figure reported on the FY 1999 balance sheet. However, material weaknesses continue to plague the IRS because of the lack of internal controls over its P&E.

The CFO, Chief Information Officer (CIO), and Chief, Agency-Wide Shared Services (AWSS), are working to resolve both accounting and accountability issues. The CIO organization conducted a comprehensive inventory to ensure that all critical systems were identified and made Year 2000 compliant. This report provides the IRS with our assessment of the actions taken to improve P&E valuation and accountability. We are also issuing a separate report addressing issues specific to automated data processing (ADP) assets.

Results

The IRS took steps to obtain a figure acceptable to the GAO for P&E and to sustain the September 30, 1999, balance sheet figure through FY 2000.

The IRS took steps to obtain a year-end figure acceptable to the GAO for the value of P&E reported on the September 30, 1999, balance sheet. The consultant used a statistical sampling process to identify and value IRS P&E assets. The GAO accepted the sampling plan because it provided for an auditable figure for P&E as of September 30, 1999. The IRS' total P&E was estimated at \$1.3 billion as a result of the sampling process.

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Also, the IRS initiated action to sustain the reliability of the September 30, 1999, balance sheet figure through FY 2000 and beyond. A Memorandum of Understanding (MOU) was developed and agreed to by the CFO, CIO, and Chief, AWSS. The MOU identified the responsibilities of each function. The CFO also established an Asset Valuation Project Office to assist in accounting for inventory. The IRS is in the process of developing procedures to accomplish the goals outlined in the MOU.

While the actions taken allowed the IRS to obtain an acceptable P&E valuation for FY 1999 and to lay a foundation for an improved inventory accountability process, the following additional actions are needed:

- Responsibility for asset management should be assigned to one senior executive.
- Differences with the interpretation or application of accounting standards and policies should be resolved.
- MOU commitments should be implemented timely.

Responsibility for Asset Management Should Be Assigned to One Senior Executive

Several components of the IRS have responsibility for different aspects of P&E financial reporting and accountability.

- The CFO is responsible for directing, managing, and providing policy guidance and oversight of financial management operations consistent with responsibilities of the Department of the Treasury.
- The IRS Commissioner designated the CIO as the sole official responsible for ownership and control of all ADP property.
- The AWSS organization, through its Office of Procurement, is responsible for establishing policy

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Cross-functional responsibilities create a challenge for the IRS to manage P&E.

and guidance and overseeing the acquisition of goods and services for the IRS.

Further, accountability for and control over assets is vested throughout the IRS management hierarchy as part of the managers' operational duties.

Sustaining the P&E figure is one of the goals of IRS financial management and is dependent on the ability of the three functions to coordinate and deliver on their responsibilities. However, these cross-functional responsibilities create a challenge for the IRS in effectively managing its P&E. Neither the CIO nor CFO have authority over the resources provided by other functions to ensure the accuracy of the inventory databases.

The Chief Financial Officer's Act of 1990 designates agency CFOs as responsible for directing, managing, and providing policy guidance and oversight of agency financial management operations. These responsibilities include the implementation of agency asset management systems. The Department of the Treasury is one of the agencies listed in the Act. As a bureau of the Department, the IRS is charged with ensuring its compliance with the legal and departmental requirements.

Since the existing IRS responsibility for administering the asset management program crosses functional lines, an overall asset manager responsible for accountability and accounting needs to be assigned. The IRS took a positive step in this direction when the IRS Commissioner designated the CIO as the sole official responsible for ownership and control of all ADP property.

An additional designation of a single senior executive with overall responsibility for all P&E should improve the IRS' ability to sustain the FY 1999 P&E figure and to properly manage and control capital assets.

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Recommendation

1. The Deputy Commissioner Operations should designate a senior executive responsible for overall asset management. This executive should have the authority to resolve conflicts over functional responsibilities.

Management's Response: Management disagrees with the recommendation. Since the Commissioner gave authority to the Chief Information Officer (CIO) to perform those functions having Servicewide impact and relating to the acquisition of information technology (IT) and the management of information resources, the IRS does not plan to designate another responsible official. However, the IRS will use the new Inventory Technology Asset Management System (ITAMS) for non-IT P&E so that the IRS will have one P&E inventory system. All levels of management will be responsible for assuring that policies for managing the P&E are carried out.

Office of Audit Comment: Although the Commissioner gave the CIO the authority to perform those functions impacting and relating to the acquisition of IT assets and the management of information resources, the CIO does not have the authority to resolve conflicts that may arise between the CIO, CFO, Chief AWSS, and other functional organizations relating to the recording and control of P&E. Also, the CIO is not responsible for non-IT assets. The IRS is relying on all levels of management to assure that the policies for managing P&E are properly carried out. This is basically the same policy that the IRS followed in the past that resulted in inadequate control and accountability over P&E.

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Differences with the Interpretation or Application of Accounting Standards and Policies Should Be Resolved

The GAO raised several concerns over the application of accounting standards and policies followed by the IRS in its FY 1999 IRS Financial Statement Audit. The concerns centered on recurring material weaknesses with the inventory system and the IRS' inability to control its assets.

The accounting profession defines assets as tangible or intangible items that have probable economic benefits. Capital assets are defined as non-expendable property with a useful life of 2 or more years and an acquisition cost above a pre-determined dollar value threshold. The IRS also has stewardship (accountability) responsibility over Working Capital Fund (WCF) assets, which are defined as goods and services acquired by the Treasury's WCF to maximize economic benefit. See Appendix IV, Glossary of Terms, for additional definitions.

The IRS should take additional steps to ensure consistent compliance with accounting standards and policies.

The IRS needs to address the following issues to resolve existing differences in the interpretation or application of accounting standards and policies:

- Re-evaluate financial information used to support any capitalization threshold used in the future.
- Determine the appropriateness of actions related to the stewardship of WCF assets.
- Define a method for treatment of leasehold improvements.

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Re-evaluate financial information used to support any capitalization threshold used in the future

Differences exist concerning the appropriateness of the capitalization threshold. The IRS set the threshold at \$50,000, which is within the provisions of Treasury policy. The GAO believes the threshold may be too high.

Establishing an appropriate threshold for capitalizing assets has been the subject of considerable debate in the Department of the Treasury, IRS, and GAO. There are differences between the IRS and GAO concerning the appropriateness of the threshold level. The IRS used a capitalization threshold of \$50,000 for FY 1998, a level within the provisions of Treasury policy. The GAO's position was that the threshold may be too high. In its report on the IRS' FY 1999 financial statements,³ the GAO stated that the upward adjustment of over \$1 billion to the net P&E balance for FY 1999 confirmed its FY 1998 conclusion that P&E were likely materially understated. This understatement was due in part to the threshold allowing millions of dollars of P&E purchases to be expensed rather than capitalized as assets.

Statement of Federal Financial Accounting Standards (SFFAS) No. 6 provides for the accounting treatment of federally owned P&E. However, SFFAS No. 6 does not specify an amount for the capitalization threshold. The SFFAS requires federal entities to consider their own financial and operational conditions in establishing an appropriate threshold. The Department of the Treasury established a departmental policy for capitalization thresholds between \$25,000 and \$50,000.

Materiality must be considered in the establishment of a capitalization threshold.

In addition to the guidance for acceptable thresholds, the Statement on Auditing Standards No. 47 and Financial Accounting Standards Board Concepts No. 2 establish guidance on materiality. Materiality is stated to be a matter of professional judgment with considerations for quantitative and qualitative analysis.

³ GAO/AIMD-00-76 *Financial Audit: IRS' Fiscal Year 1999 Financial Statements*. The IRS reported \$1.281 billion in P&E for FY 1999 and \$202 million in FY 1998. For FY 1999, an outside consultant did not use a threshold amount when estimating the P&E balance.

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Research of private sector companies resulted in identifying capitalization thresholds ranging from \$500 to \$5,000.

We contacted several private sector businesses to identify best practices on the establishment and use of thresholds and found frequent use of capitalization thresholds between \$500 and \$5,000. One factor that should be considered when establishing a threshold is what an outside reader of financial statements reasonably expects a P&E figure to represent, taking into account the definition of capital assets and the concept of materiality.

Hampering the IRS' ability to effectively analyze its current inventory system is the fact that the system does not capture cost or valuation information for all assets. To do so with its existing systems, the IRS should use a data element (such as a purchase order or procurement award number) common to both the financial and inventory systems so that cost information can be linked to the assets, thus facilitating a capitalization threshold analysis.

In the past, the IRS has analyzed its inventory systems, providing dollar amounts and unit counts of P&E on various threshold levels. As mentioned previously, because the cost information has not always been properly recorded and controls over property are a material weakness, the reliability of the data in these analyses is at risk. Once these issues are corrected, a re-evaluation of the data may suggest an appropriate threshold level that effectively balances sound financial reporting with the costs to maintain associated records.

Determine the appropriateness of actions related to the stewardship of WCF assets

The IRS needs to resolve existing differences as to handling WCF assets.

Existing differences between the GAO and IRS on handling WCF assets need to be resolved. The GAO's position is that the assets should remain in the IRS' inventory systems. However, the IRS intends to delete the assets from the existing inventory system.

Assets purchased through the WCF are goods and services acquired on behalf of Treasury bureaus to maximize economic benefit. An outside consultant advised the IRS that the Department of the Treasury, not

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the IRS, owns WCF assets. Accordingly, the consultant recommended the WCF assets be shown in the Departmental Office's financial statements. The outside consultant also reported that the IRS records WCF assets in its P&E inventory system for safeguarding, tracking, and configuration purposes.

The GAO also proposed that the IRS continue recording the WCF assets in its inventory system. However, according to the MOU, the IRS plans to delete the assets from its inventory system. Deleting the WCF assets from the inventory system will jeopardize the IRS' compliance with stewardship (accountability) requirements over assets. The IRS should reconsider its position to delete WCF assets until differences with the GAO's position and generally accepted accounting principles are resolved.

Define a method for treatment of leasehold improvements

The IRS' current treatment of leasehold improvements has been the subject of recent debate.

The IRS' treatment of leasehold improvements has been the subject of recent debate. The GAO's position on leasehold improvements is that capitalization should be based on the total completion of stated improvements. The IRS' position, which is consistent with the position of its outside consultant, is that capitalization should be based on incremental completion and use.

SFFAS No. 6 states that P&E include not only assets acquired through capital leases but also leasehold improvements. This statement is silent on any further definitions or provisions for the accounting treatment of leasehold improvements.

Accounting Principles Bulletin⁴ No. 17 defines leasehold improvements to be capitalized by the lessee in a separate leasehold improvement account. The leasehold improvements are to be amortized over the shorter of the lease term or the life of the property resulting from the improvement, but shall not exceed 40 years.

⁴ Accounting Principles Bulletins are accepted accounting practices to be followed by all business enterprises.

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Furthermore, Treasury Department Policy (TDP) 32-01 states that improvements made to non-government owned buildings, structures, and systems occupied by a bureau as lessee should be capitalized as leasehold improvements. Capitalization should be based on the cost to the bureau and amortized over the period of the lease or the life of the improvements, whichever is less.

Although these pronouncements do not specifically address the issue of when to start amortizing leasehold improvements, the accounting principle of matching expenses with the useful benefits of the improvement suggests that the IRS position may be preferable.

Recommendations

2. The IRS should ensure that pertinent cost or valuation information is included in the inventory systems, and that this information is re-evaluated to establish any capitalization threshold used in the future. The GAO and the Department of the Treasury should be consulted on any changes to the threshold.

Management's Response: The IRS has adopted a process to pool assets for valuation purposes. Under the pooling procedure, the cost or value of assets is not recorded in the inventory. All cost information comes from the IRS system of record for financial information, the Automated Financial System. Under the pooling procedure, capitalization thresholds are not applied to pooled assets. The cost of all assets included in the pool would be accumulated. In addition, the IRS did not use capitalization thresholds in FY 1999 or FY 2000. However, when the IRS re-evaluates capitalization thresholds, they will consult with interested stakeholders.

Office of Audit Comment: We agree that capitalization thresholds do not apply to the pooling concept; however, at the completion of our fieldwork in March 2000, the pooling concept had not been adopted. IRS

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management was planning on recording the cost of FY 2000 purchases in the inventory systems, and the capitalization threshold would have been an issue. We also agree that the threshold was not used for FY 1999, as the consultant's statistical sample was taken without regard to the value of the assets shown on IRS records. As described earlier in this report, this sampling process was used for FY 1999 to identify and value IRS P&E assets. Our recommendation now focuses on the need to re-evaluate capitalization thresholds if the pooling concept is not employed in future attempts to record the value of P&E in financial or inventory management systems. Additionally, we are encouraged by IRS management's commitment to consult with interested stakeholders on this issue.

3. The CFO, CIO, and Chief, AWSS, should reconsider their position to delete WCF assets from the current inventory system until the inconsistencies around the treatment of WCF assets are resolved. This would ensure that the IRS is in closer compliance with established accounting standards and policies and its stewardship of assets.

Management's Response: Management disagrees with the recommendation. In a recent management letter to IRS, the GAO clearly recognized that the Department of the Treasury owns the WCF assets. The accounting standards and policies do not require the IRS to include Treasury owned assets on its property records, and the IRS believes it is appropriate to delete these assets from IRS property records.

Office of Audit Comment: As our report states, an outside consultant advised the IRS that the Department of the Treasury and not the IRS owns WCF assets, and we agree with the ownership issue as it relates to recognizing the value on Departmental (as opposed to IRS) financial statements. The ownership and financial reporting of WCF assets was also the thrust of the background paper that IRS management provided to us in September 1999. Our concern over WCF assets

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involves the proper treatment of these assets for inventory tracking (as opposed to valuation) purposes. In its March 1999 report, the outside consultant stated that the WCF assets are entered in the IRS inventory system for safeguarding, tracking, and configuration purposes and recommended that the IRS use a specific code to identify WCF assets. In our opinion, this would enhance IRS' ability to effectively carry out its stewardship responsibilities, as the IRS has physical custody of these assets.

4. The IRS should resolve with the GAO the differences over the accounting treatment of leasehold improvements by establishing a position that is consistent with both the pronouncements governing leasehold improvements and the matching principle.

Management's Response: Management disagrees with this recommendation. The IRS believes that they have established a position that is consistent with the accounting standards. GAO disagrees with that position, but at this point has not given the IRS a basis for changing the IRS' approach.

Office of Audit Comment: The intent of our recommendation is to bring the GAO and IRS together to resolve the difference of opinion on the leasehold improvement issue. The fact that GAO disagrees with the IRS position on leasehold improvements is the basis for our recommendation.

Memorandum of Understanding Commitments Should Be Implemented Timely

In order for the IRS to meet the requirement of producing auditable financial statements, all capital assets must be properly valued.

For FY 1999, the GAO concurred with a statistical approach for establishing a baseline value for capital assets. The IRS recognized the need for sustaining this value and developed an MOU to describe interim procedures to be followed by the CFO, CIO, and AWSS

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Most of the actions committed to in the MOU are contingent upon additional actions that have not been implemented.

organizations. These interim procedures will be used until an integrated system is in service.

While the IRS continues its efforts to integrate its financial system, existing systems can allow for the interim processes to be successful. With an updated and properly maintained inventory system, the IRS can achieve success in sustaining the P&E figure. However, it will also require a diligent effort to timely deliver on commitments outlined in the MOU.

Many of the commitments and planned actions in the MOU are contingent upon additional actions that need to be taken. For example, exception reports will be used to determine equipment purchased, but not recorded; however, report parameters have not yet been defined. Resources were committed to the establishment of the Single Point Inventory Function to account for ADP assets, but resources have not yet been committed to account for new purchases or the recordation of the assets purchased in FY 2000. In addition, the CFO function has created an Asset Valuation Project Office to assist with implementing actions in the MOU. As of March 2000, only one staff position had been dedicated to this office.

At the end of our fieldwork, nearly half the fiscal year had passed. Accordingly, if the IRS does not implement the MOU commitments, it is at risk of not sustaining the P&E figure established for the FY 1999 financial statements. Also, if the IRS does not identify and accurately account for all assets purchased after September 30, 1999, the IRS will not sustain the FY 1999 P&E figure. As a result, the IRS will have spent \$1.5 million for contractors to obtain a P&E figure for FY 1999, and may not be able to efficiently build upon this effort for FY 2000 and beyond.

Recommendation

5. The CFO, CIO, and AWSS organizations should immediately commit to the tasks and actions outlined in the MOU and provide sufficient

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resources to effectively carry out the intent of the MOU.

Management's Response: Since February 2000, a subcommittee has been working on the property control material weakness. A number of procedures have changed, and as work progressed it became clear to senior officials that the MOU needed to be reworked. A revised MOU was adopted in September 2000.

Office of Audit Comment: Since completion of our fieldwork, the IRS has adopted a pooling concept to account for the value of assets. In their response, IRS management advised that the acquisition costs by year for each selected class (pool) of assets will be accumulated in the accounting records and depreciated over the useful life of the assets. Pooling will allow the IRS to eliminate the differences between values in property (inventory) and accounting records because no or nominal values will be recorded in the property records. In our opinion, this reduces our concern about the ability to build on the efforts expended by the contractors in FY 1999, as the IRS will no longer be entering cost information in its property records and using that information for financial reporting purposes. Prior to adopting the pooling concept, the IRS was planning on entering cost information in the property records as in prior years.

Conclusion

The IRS took steps to obtain a figure acceptable to the GAO for the value of P&E reported on the FY 1999 balance sheet and appropriately recognized the need to sustain the figure for FY 2000 and beyond. The IRS developed an MOU identifying the responsibilities of the CFO, CIO, and Chief, AWSS, and the CFO established an Asset Valuation Project Office as tools to better manage P&E.

Continued involvement by senior management is necessary to sustain a reliable inventory figure and to

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address fundamental issues that will have an impact on the long-term viability of a P&E inventory system. The IRS needs to ensure that responsibility for asset management is assigned to one senior executive, differences with accounting standards and policies are resolved where necessary, and commitments in the revised MOU are implemented timely.

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate asset management in the Internal Revenue Service (IRS). In particular, we evaluated IRS plans and procedures to properly account for property and equipment (P&E) and determined whether effective procedures and controls were established to ensure P&E balance sheet figures for Fiscal Year (FY) 1999 financial statements will be sustained through FY 2000 and beyond. We completed the following audit tests:

- I. Determined whether the IRS performed readiness checks to properly account for P&E.
 - A. Reviewed policies and guidelines governing the proper accounting for P&E in terms of capitalization thresholds, internal use software, bulk purchases, capital leases, and working capital fund purchases.
 - B. Identified current industry standards and accepted practices for properly accounting for P&E. Visited private sector firms in the financial and information technology areas as well as comparable federal agencies (through the respective Inspectors General).
 - C. Determined whether the IRS is appropriately allocating resources to address General Accounting Office concerns related to properly accounting for P&E.
 - D. Determined whether the IRS has established accountability, at both the executive and operating levels, and committed the resources to effectively manage and account for P&E.
 - E. Determined whether proper levels of training have been provided to functions and personnel responsible for asset management.
- II. Determined whether procedures and controls were established to ensure FY 1999 P&E balance sheet figures could be sustained through FY 2000.
 - A. Reviewed current policies and procedures in place to account for P&E.
 - B. Identified current systems and processes that the IRS used to account for P&E and the effect of any planned changes to these existing systems.
 - C. Evaluated the IRS methodology for proper valuation of P&E for both existing and new purchases.

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- D. Evaluated the appropriateness of the IRS' accounting for assets from October 1, 1999, through the date of the inventory validation performed by the contractor.
- E. Identified efforts to integrate a system to properly account for P&E from procurement through disposal.

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Appendix II

Major Contributors to This Report

Maurice S. Moody, Associate Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

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Appendix III

Report Distribution List

Deputy Commissioner Operations C:DO
Chief Financial Officer CFO
Chief Information Officer IS
Chief, Agency-Wide Shared Services A
Director for Systems and Accounting Standards CFO:S
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National Taxpayer Advocate C:TA
Office of Management Controls CFO:A:M
Director, Office of Program Evaluation and Risk Analysis M:O

Glossary of Terms

Assets – tangible or intangible items, owned by the federal government, which would have probable economic benefits that can be obtained or controlled by a federal government entity.

Bulk Purchases – include the acquisition of like items over a short period of time that collectively exceed the capitalization threshold of an entity, but the cost of the individual assets is less than the threshold.

Capital Assets – land, structures, equipment, and intellectual property (including software) that are used by the federal government and have an estimated useful life of two or more years.

Capital Leases – leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one of the following four criteria, it is classified as a capital lease by the lessee:

- a) transfers ownership of the property to the lessee by the end of the lease term;
- b) contains an option to purchase the leased property at a bargain price;
- c) lease term is equal to or greater than 75 percent of the economic useful life of the leased property; or
- d) present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.

Capitalization Threshold – Statement of Federal Financial Accounting Standards No. 6, Accounting for Property and Equipment (P&E), does not set a capitalization threshold for P&E. The Federal Accounting Standards Advisory Board noted the diversity of federal entities and determined that thresholds should be established by individual entities rather than centrally.

Internally Developed Software (Internal Use Software) – software developed by personnel employed by the reporting entity. This includes modifications made by entity personnel to purchased or contractor-developed software.

Leasehold Improvements – permanent improvements to leased property that is occupied by a bureau as a lessee.

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Property and Equipment – tangible assets that: a) have an estimated useful life of 2 or more years; b) are not intended for sale in the ordinary course of business; and c) are intended to be used or available for use by the entity.

Statement of Federal Financial Accounting Standards No. 6, Accounting for Property and Equipment – establishes standards for most capital assets.

Working Capital Fund (WCF) Assets – goods and services acquired by the WCF for Department of the Treasury bureaus to maximize economic benefits.

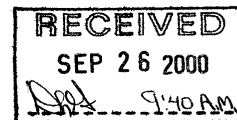
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Appendix V

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224



September 25, 2000

MEMORANDUM FOR PAMELA J. GARDINER
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:

for Bob Wenzel *David J. Amodeo*
Deputy Commissioner Operations

SUBJECT:

Draft Report - The Asset Management Program Can Be
Successful Through Active Executive Monitoring and Oversight

Thank you for the opportunity to review your draft report on IRS' Asset Management Program. Attached is our response to specific statements and recommendations in the report.

We have a number of concerns about the recommendations in your report, as well as the underlying narrative, which supports the recommendations. Since the audit fieldwork was completed in March 2000, the IRS has changed its approach for determining a value for property and equipment. The IRS is using a procedure to pool the value of the assets. Under this procedure, the cost of assets is recorded in the accounting records, the individual items are recorded in the property records, and the information in the two systems is linked through the use of common data elements reported in both systems. A pool is depreciated over the useful life of its assets. Disposal of individual assets will be recognized on the property records, but will not be recognized on the accounting records unless the disposition was of a material amount.

We provided much of the information that follows in the attachment in discussions with the TIGTA audit staff, but we are providing it here to assure we are clear in our concerns.

Please contact Lawrence W. Rogers, Acting Chief Financial Officer, at (202) 622-6400 if you have any questions, or your staff can contact Steven Goldberg, Director, Administrative Accounting, Systems and Policies, at (301) 492-5315.

Attachment

The Asset Management Program Can Be Successful Through Active Executive Monitoring and Oversight

Attachment

Draft Report - The Asset Management Program Can Be Successful Through Active Executive Monitoring and Oversight

Since the completion of fieldwork by the TIGTA audit team in March 2000, the IRS has taken a number of actions to correct the material weakness of property management. The most important financial change is that the IRS has adopted a process to pool the assets for valuation purposes. The pooling process relies on the cost data in the accounting system for property values rather than values in the property inventory system. With the adoption of the pooling process, the IRS no longer records the asset value in the property inventory system. To link the accounting system property records with the inventory systems, the IRS has selected the Procurement Award Number as the common identifier. This common identifier will allow us to trace a payment from the invoice to a specific piece of equipment and from a piece of specific equipment to the invoice. The Procurement Award Number will be noted in the property system and already exists in the accounting system.

In the Executive Summary on Pages i through iii, there are three recommendations on Page iii.

Regarding the first recommendation, that the IRS should assign overall program responsibility to one senior official, we have taken this step by appointing the Chief Information Officer (CIO) as the principal person responsible for the Information Technology (IT) equipment. Until the CIO inventory system is upgraded, the non-IT equipment will continue to be controlled by the Property Assets Tracking System (PATs), and is the responsibility of the Chief, Agency-Wide Shared Services. When the upgrading is completed, all IRS property will be tracked in one property system.

Regarding the second recommendation, that the IRS should determine a capitalization threshold, we are currently using the pooling concept for property value, which means there is no threshold. When an integrated financial management system is installed, we will consider whether to return to the threshold IRS had used until 1998 or adopt a new one.

Regarding the third recommendation that the IRS should aggressively pursue the actions in the Memorandum of Understanding (MOU) for property management, that aggressive pursuit has been ongoing throughout Fiscal Year 2000 and especially since February 2000 when the Property Subcommittee was formed. The MOU was recently revised to take into account the changes in procedures and to improve the effectiveness of the reforms over the longer run.

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Below are specific clarifications about the report narrative:

Page ii, Paragraph 2, Sentence 2

"Some IRS policies and procedures on these issues conflict with accounting standards and definitions, general business practices, and other guidance."

In discussions with the TIGTA staff about this statement, we asked for information on the specific IRS policies, accounting standards and definitions, general business practices, and other guidance along with a description of the perceived differences. The example given in this paragraph of the \$50,000 threshold for capitalization is incorrect for FY 99 and FY 2000 since the IRS did not use capitalization thresholds in either year. In addition, this example does not highlight a difference between policy and the accounting standards. Without any specific information, it is impossible to respond to this statement. We suggest that either this statement be removed from the final report or specific information be provided.

Page ii, Paragraph 3

"A complete and accurate inventory system would allow the IRS to establish a capitalization threshold based on a sound analysis, account for WCF assets, identify capital leases, and track leasehold improvements." (Emphasis added by IRS)

It has been clear since September 1999, that the Working Capital Fund (WCF) assets will not be accounted for by IRS. The IRS prepared a paper that month on this issue which GAO audit staff reviewed, including consultation with the GAO legal staff, and concluded that the IRS should not be tracking the WCF assets on its inventory systems. A copy of the paper was sent to Maurice Moody on September 23, 1999. As a result, all IRS bar codes have been removed from the WCF equipment and the equipment has been removed from the Integrated Network and Operations Management System (INOMS) inventory system as well.

Page iii, Paragraph 1, last two sentences

"Substantial implementation of the MOU had not occurred at the conclusion of our review. IRS needs to timely act on several key provisions, including accounting for all purchases made after September 30, 1999, defining exception report parameters, and committing resources to P&E activities."

Since the fieldwork by the TIGTA audit staff ended in March, and the Property Subcommittee had been at work only since February, this conclusion is premature. The Subcommittee had analyzed the issues and considerable progress had been made by March 30. Attached is a short paper, which summarizes the changes that have occurred. (See Attachment 1)

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Page 3, Paragraph 1, Sentence 3

"GAO accepted the sampling plan because it provided for an auditable figure for P&E as of September 30, 1999."

We suggest you add another sentence explaining that the estimate the IRS used to project the net value for the property and equipment (P&E) was in compliance with the accounting standards and the GAO accepted it as an appropriate course of action.

Page 5, Paragraph 3, Sentence 3

"The IRS also has stewardship (accountability) responsibility over Working Capital Fund (WCF) assets."

Please correct this sentence based on the observations above and the paper that was written for GAO in September 1999, and agreed to by the GAO audit team. The WCF assets are primarily Tier IV and belong to Treasury. Treasury has an inventory system that automatically notifies them if a piece of WCF equipment has been taken off-line or has been removed. The stewardship responsibility belongs to Treasury.

Page 5, 1st Bullet

"• Re-evaluate financial information used to support the established capitalization threshold."

As noted above, the IRS did not use capitalization thresholds in FY 1999 and will not use them in FY 2000. However, when we establish capitalization thresholds, we will consult with the interested stakeholders.

Page 5, 2nd Bullet

"• Determine the appropriateness of actions related to the accounting for WCF assets."

We are not sure if you are referring to financial actions or stewardship actions when you use the term "accounting" in this sense. As already noted, the ownership of the WCF assets belongs to Treasury. Charges for services would be a cost to be accounted for as a payment by the IRS. It would be helpful if this statement could be clarified.

Page 6, 1st Bullet

"• Define a method for treatment of leasehold improvements."

The IRS uses a methodology to capture leasehold improvement costs for capitalization. On Page 9, the report states the IRS position of amortizing leasehold improvements may be preferable to GAO position.

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Page 7, Paragraph 2, Sentence 1

"We contacted several private sector business to identify best practices on the establishment and use of capitalization thresholds..."

This statement could mislead a reader. In the IRS survey of best practices, we compared the IRS to other large federal agencies. For example, we found the Social Security Administration uses a capitalization threshold of \$100,000. In your survey, you used private sector companies as a benchmark. We suggest you add an explanation about the types and attributes of companies you surveyed.

Page 7, Paragraph 5, Sentence 3

"However, the IRS intends to delete the assets from the existing inventory system."

As noted several times above, the Treasury Department owns the WCF P&E. The system of record for this P&E is the WCF inventory, not the IRS inventory. Therefore, it is appropriate to delete these assets from the IRS records.

Page 8, Paragraph 1, Sentence 4

"The outside consultant also proposed that the IRS record WCF assets in its P&E inventory system for safeguarding, tracking, and configuration purposes."

This statement is incorrect. In fact, the contractor recommended that the assets be removed from the system. To resolve this discrepancy, it would be helpful to see the work papers that support this statement.

Page 8, Paragraph 2, Sentence 3

"Deleting the WCF assets from the inventory system will jeopardize the IRS' compliance with stewardship (accountability) requirements over assets."

As noted several times already, we disagree with this statement. These assets are primarily Tier IV. The WCF assets belong to the Treasury Department. Treasury has an inventory system that automatically notifies them if a piece of WCF equipment has been taken off-line or has been removed. The stewardship responsibility belongs to Treasury. Therefore, it is appropriate to delete assets that belong to someone else from the IRS records.

Pages 8 and 9; Define a method for treatment of leasehold improvements

The conclusion of this section is that the IRS method for amortizing leasehold improvements is preferable to GAO's position. We intend to use the same methodology in FY 2000 in capitalizing our leasehold improvements.

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Page 10, Paragraph 4, Sentence 4

"As a result, the IRS will have spent \$1.5 million for contractors to obtain a P&E figure for FY 1999 and will not be able to use this figure as a basis for FY 2000."

It is unclear from the report why this statement is correct. It would be helpful to know why the TIGTA auditors think that the IRS will not be able to use this figure as a basis for FY 2000. The IRS contracted for a supportable net value for P&E for the FY 1999 financial statements and the contractor delivered it. The GAO found the P&E valuation on the statements to be reasonable. Regardless of what happens in FY 2000 and beyond, the reasonableness of this value does not change, and we can use it for the FY 2000 beginning balance.

Page 10; Memorandum of Understanding Commitments Should Be Implemented Timely

Since March 2000, the IRS has changed its approach to the valuation of the assets for the financial statements. Instead of using the steps described in the original MOU, the IRS is using a procedure to pool the assets. Under the pooling procedure, the cost of assets are recorded in the accounting records, the individual items are recorded in the property records, and the information in the two systems is linked through the use of a common data element [the Procurement Award Number] reported in both systems.

Under the pooling procedure, we would establish pools by year of acquisition for each selected class of assets. The acquisition costs by year for each selected class would be accumulated in the pool for that asset class. For example, all the costs for Automated Data Processing (ADP) equipment acquired in FY 2000 with a useful life of X years would be accumulated in the FY 2000 pool for ADP equipment. Capitalization thresholds would not be applied to pooled assets. The cost of pooled assets would be accumulated.

Pooling will allow us to eliminate the differences between values in property records and values in accounting records because no values or nominal values would be recorded in the property records. A pool would be depreciated over the useful life of its assets. Disposal of individual assets would be recognized on the property records but not in the accounting records, unless there was a disposition of a material amount. Finally, applying the pooling procedure to selected classes of assets eliminates the issue of capitalization thresholds for individual asset purchases and bulk or aggregate purchases. All costs for selected classes of assets would be capitalized and depreciated.

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Our comments on the specific recommendations in this report are as follows:

IDENTITY OF RECOMMENDATION #1

The Deputy Commissioner Operations should designate a senior executive responsible for overall asset management. This executive should have the authority to resolve conflicts over functional responsibilities.

ASSESSMENT OF CAUSE

The auditors do not agree that by issuing the Policy Statement and signing the Delegation Order, that the Commissioner has designated a senior executive to be responsible for asset management.

CORRECTIVE ACTIONS

We disagree with this recommendation. On November 12, 1999, the Commissioner signed the IRS Policy Statement P-1-229, Management and Control of ADP Property. At the same time, the Commissioner signed IRS Delegation Order No. 261, which gave the CIO the authority to perform those functions having Servicewide impact and relating to the acquisition of IT and the management of information resources.

Since the majority of the value of P&E in the IRS is IT equipment, we do not plan to designate another official responsible for it. Rather, we will use the new system Inventory Technology Asset Management System (ITAMS) for non-IT P&E so that the IRS will have one P&E inventory system. In addition, all levels of management are responsible for assuring our policies for managing P&E are properly carried out.

IMPLEMENTATION DATE: None

IDENTITY OF RECOMMENDATION #2

The IRS should ensure that pertinent cost or valuation information is included in the inventory systems and that this information is re-evaluated to establish an appropriate capitalization threshold. The GAO and the Department of Treasury should be consulted on any changes to the threshold.

ASSESSMENT OF CAUSE

A fundamental disagreement exists between the Department of Treasury and the GAO about the appropriate level for a capitalization threshold. In the past, the IRS has strictly followed the Treasury policy in this matter.

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CORRECTIVE ACTION

Under the pooling procedure, the cost or value of an asset is not recorded in the inventory. All cost information comes from the IRS system of record for financial information, the Automated Financial System. Also, the IRS did not use capitalization thresholds in FY 1999 and will not use them in FY 2000. Under the pooling procedure, capitalization thresholds are not applied to pooled assets. The cost of all assets included in the pool would be accumulated. However, when we re-evaluate the capitalization thresholds, we will consult with the interested stakeholders.

IMPLEMENTATION DATE: None

IDENTITY OF RECOMMENDATION #3

The CFO, CIO, and Chief, AWSS, should reconsider their position to delete WCF assets from the current inventory system until inconsistencies around the treatment of WCF assets are resolved. This would ensure that the IRS is in closer compliance with established accounting standards and policies and its stewardship of assets.

ASSESSMENT OF CAUSE

A disagreement existed between the IRS and the GAO about the ownership of WCF assets. This disagreement was resolved during the audit of the FY 1999 Financial Statements.

CORRECTIVE ACTION

We disagree with this recommendation. Based on a paper prepared in September 1999, a copy of which was sent to Maurice Moody, Associate Inspector General for Audit, on September 23, 1999, GAO agreed that the WCF equipment was the property of Treasury, not the IRS. In its recent management letter to IRS, the GAO clearly recognized that the Department of Treasury owns the WCF assets. We are not aware of any outstanding disagreement between the IRS and GAO about ownership of WCF assets. The accounting standards and policies do not require the IRS to include Treasury owned assets on its property records. We believe it is appropriate to delete the WCF assets from IRS property records.

IMPLEMENTATION DATE: None

IDENTITY OF RECOMMENDATION #4

The IRS should resolve with the GAO the differences over the accounting treatment of the leasehold improvements by establishing a position that is consistent with both the pronouncements governing leasehold improvements and the matching principle.

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ASSESSMENT OF CAUSE

A disagreement existed between the IRS and the GAO over the accounting treatment of the leasehold improvements.

CORRECTIVE ACTION

We disagree with the recommendation. In the body of this report, you state that the IRS position on leasehold improvements is preferable to the GAO position. We interpreted this to mean that our position meets the various pronouncements and principles. We believe that we have established a position that is consistent with the accounting standards. GAO disagrees with that position, but at this point has not given the IRS a basis for changing our approach.

IMPLEMENTATION DATE: None

IDENTITY OF RECOMMENDATION #5

The CFO, CIO, and Chief, AWSS organizations should immediately commit to the tasks and actions outlined in the MOU and provide sufficient resources to effectively carry out the intent of the MOU.

ASSESSMENT OF CAUSE

Concern about implementation of the MOU by TIGTA auditors.

CORRECTIVE ACTION

As discussed above, there has been a Subcommittee working on the property control material weakness since February 2000. We have changed a number of procedures, and the record of that progress is specified in Attachment 1. As the work progressed, it became clear to the senior officials in the Subcommittee that the MOU needed to be reworked to make the agreements more effective. This was recently completed, and it is included in this response as Attachment 2.

IMPLEMENTATION DATE: February 2000, and ongoing.

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Response to GAO Property and Equipment Recommendations

Over the past two years IRS senior management has focused its attention on the issue of accountability over P&E. This attention has resulted in actions designed to provide long term solutions for IRS' P&E issues. The solutions to improve IRS' accountability over P&E involve establishing a baseline value of IRS P&E, a reengineering of the relevant business processes, a revision of P&E policies and procedures, a redesign of IRS' property system, and the development and implementation of a comprehensive inventory strategy.

In July 2000, the General Accounting Office (GAO) issued a draft audit report titled, "Recommendations to Improve Financial and Operational Management." The report included a summary of 99 recommendations including 17 recommendations that address IRS' accountability over property and equipment (P&E). These 17 GAO property recommendations primarily address issues associated with IRS' policies and procedures for recording and valuing P&E, and for conducting P&E inventories.

In FY 1999, IRS established a baseline value for its P&E by overseeing the implementation of a sampling plan designed to estimate the net book value of its P&E as of September 30, 1999. To build on and sustain the FY 1999 initiative, IRS, in FY 2000, created a Subcommittee of the Financial and Management Controls (FMC) Executive Steering Committee. The Deputy Commissioner for Operations chairs the FMC. The Subcommittee has been devoted to developing a strategy and solutions to resolve the long-term property issues. The IRS has recognized these issues as a material weakness since 1983.

The Subcommittee is coordinated by the Acting CFO and consists of senior Information System, Procurement, and CFO officials. These officials meet weekly to monitor the progress made in addressing P&E issues, ensure solutions are coordinated, and identify actions needed to ensure progress continues. Some of the specific steps being monitored by the Subcommittee include:

- Reengineering P&E business processes with the establishment of the Single Point Inventory Function (SPIF) coordinators in the Information Systems (IS) office to assure control over IS property and equipment. The reengineered business processes include revised policies and procedures designed to support the implementation of the new property system.
- Establishing a single common identifier that will link the Requisition Tracking System (RTS), the Automated Financial System (AFS) and the Integrated Network and Operations Management System (INOMS) property system. The identifier is the procurement award number.
- Developing a property system to replace INOMS and PATS. The new property system will be a single point of entry system that integrates procurement, financial

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and property information for all IRS property, both ADP and the non-ADP property that was once covered by the PATS.

- Establishing a comprehensive inventory strategy designed to improve the process for planning, conducting, and reconciling the P&E inventory.

IRS has elected for Fiscal 2000 to implement the pooling concept for the capitalization of IT P&E. Under the pooling concept, all IT P&E acquired after September 30, 1999, will be capitalized. P&E that is uniquely identified with a unit cost of more than \$500 will be linked to property recorded in the INOMS system through the use of the procurement award number. The procurement award number will be associated with the invoice in the accounting system and the property listed in the INOMS system. Pooling is viewed as a short-term solution until the integrated property system designed to replace INOMS and PATS is implemented.

To establish the FMC Subcommittee for P&E, the three principal units prepared and issued a Memorandum of Understanding (MOU). The MOU was signed on February 9, 2000, by the Chief Financial Officer (CFO), Chief Information Officer (CIO), and Chief, Agency-Wide Shared Services (AWSS). It listed the responsibilities of each organization for maintaining control over assets. This MOU described a set of procedures to be used until an integrated system is acquired. The staffs of the three offices have worked on a daily basis to put the MOU in motion. To ensure the MOU will meet the goal of an adequate asset management program, the FMC Subcommittee has met weekly. At each meeting the staff briefs the Subcommittee on the current status of all the ongoing property management projects. Management immediately provides feedback and makes any necessary decisions regarding the projects and the need to possibly shift their efforts or provide additional resources, etc. Based on this approach the IRS will have: 1) control of its asset management responsibilities, and; 2) addressed any appropriate property and equipment recommendations issued by the GAO.

As the working groups implemented action items in the MOU it became evident that some of the items were overtaken by events. This created a need to revise the MOU to enable the IRS to adequately account for and control its property and equipment. A copy of the revised MOU is attached. The IRS has already addressed and completed many of the action items as indicated. Listed below are some of the actions (in a more detailed level than shown on the MOU) that have already been addressed and those planned for the near term.

- Develop an Engineering Work Plan for a Single Point Inventory Function (SPIF) implementation at all IRS sites (Service Centers, Computing Centers and District Offices). (Completed 1-31-2000)
- Capture costs internal to the IRS for the installation of software or other actions taken in anticipation of placing the asset into service will be identified through the PCAS codes and capitalized as part of major project capitalization. This practice is currently in place for all projects identified as major projects and will be formalized in an interim procedure. (Completed 2-9-2000)

The Asset Management Program Can Be Successful Through Active Executive Monitoring and Oversight

- Develop and issue interim guidelines to implement Single Point Inventory Function (SPIF). The purpose of the SPIF is to establish clear accountability in the receipt, distribution, excess and/or dispose of ADP hardware, software, and telecommunications throughout the various IRS locations. (Completed 3-15-2000)
- Draft an IRS-wide policy statement for signature by the Deputy Commissioner for Operations stressing the importance of assigning proper accounting strips to all acquisitions, especially related to the correct SOC and PCAS codes. (Completed 3-16-2000)
- Prepare and provide AWSS a checklist for determining if a lease is a capital or operating lease. (Completed 3-23-2000)
- Capture the costs of such things as shipping, delivery and installation that appear on the vendor's invoice. Include those costs as part of the process of identifying and capitalizing the overall cost of the asset. This practice is currently in place for all assets identified as capitalized assets and will be formalized in an interim procedure. (Completed 3-31-2000)
- Require all Contracting Officers to notify the Office of the CFO of all lease acquisitions with total payments in excess of \$50,000, beginning no later than April 1, 2000. (Completed 4-1-2000)
- Review all referred lease documents for possible inclusion as capital leases. (Target Date - Ongoing)
- Review all lease documents for assets acquired prior to April 1, 2000, no later than September 30, 2000, and inform inventory coordinators of any adjustments required to the ownership codes. (Target Date - Ongoing)
- Determine which common data field will be used to systemically link the Request Tracking System (RTS), Automated Financial System (AFS), and Integrated Network and Operations Management System (INOMS). (Completed 6-14-2000)
- Solicit support from the Office of Program Evaluation and Risk Analysis (OPERA) to review and analyze financial data from the Automated Financial System (AFS) provided by the CFO and determine whether appropriate SOC codes are being assigned by the acquiring units. This information will be shared with the CIO and AWSS organizations so that corrective action can be taken, where necessary. (Target Date 9-15-2000)
- Revise IRS' capitalization policy to include the capitalization of major projects. The policy revision has been formalized but not yet documented. (Target Date 10-1-2000)

Attachment: MOU

The Asset Management Program Can Be Successful Through Active Executive Monitoring and Oversight

MEMORANDUM OF UNDERSTANDING CAPITALIZED PROPERTY AND EQUIPMENT TRACKING - OFFICE RESPONSIBILITIES SEPTEMBER 8, 2000


| Agency Wide Shared Services (AWSS) | Chief Information Officer (CIO) | Chief Financial Officer (CFO) |
|--|--|---|
| <p>1 Provide a bi-weekly report to the Office of the Chief Information Officer, identifying all ADP assets that have been purchased by the IRS during the previous reporting period. The report will be based on information from the Request Tracking System. The Office of the CIO has defined the parameters and format for the report. (Completed)</p> <p>2 Draft a memorandum for signature by the CIO and the Chief, Agency-Wide Shared Services stating that it is essential that all requisitions entered into RTS include valid destination(s) for each Contract Line Item Number (CLIN). The memorandum will also state that the Director, Procurement, will no longer accept destinations as an attachment outside of the RTS system and will not process requisitions that do not include the destination(s) for each CLIN. It is incumbent upon each person involved in the approval process to ensure that destination(s) are included for each CLIN in the requisition. Requisitions not meeting this standard will not be accepted by Procurement and will be returned to the initiator. (Completed)</p> <p>3 Require from the vendors that procurement award numbers be included on the shipping label. (Completed)</p> <p>4 Ensure that accurate "Accounting Strip" coding (with specific attention to the SOC) is entered in RTS/IPS for all AWSS acquisitions by AWSS Financial Plan Managers.</p> | <p>1 Ensure that the Procurement Award Numbers and Requisition Numbers are entered into the INOMS look-up table for users to validate against when adding new records with a Ready For Use (RFU) date greater than September 30, 1999.</p> <p>2 Change coding of the INOMS system to remove the requirement to carry cost in the inventory record after June 30, 2000, and to require the validation of the Procurement Award Number and or Requisition Number to a standard table.</p> <p>3 Ensure received and ready for use dates are properly entered by the INOMS Coordinator.</p> <p>4 Ensure that proper values and ownership codes are recorded in INOMS.</p> <p>5 Ensure disposal dates and codes are properly and timely entered by the INOMS Coordinators.</p> <p>6 Enforce a policy (see CFO-6) for all Financial Plan Managers working under the CIO to ensure that accurate "accounting strip" coding, with specific attention to the SOC and PCAS code, is being entered in RTS/IPS for all CIO approved acquisitions.</p> <p>7 Delete all Working Capital Fund and TIGTA assets from the INOMS system and ensure that future working capital fund acquisitions are no longer entered in INOMS.</p> | <p>1 Solicit support from the Office of Program Evaluation and Risk Analysis (OPERA) to review and analyze financial data from the Automated Financial System (AFS) provided by the CFO and, to the extent possible, determine whether appropriate SOC codes are being assigned by the acquiring units. This information will be shared with the CIO and AWSS organizations so that corrective action can be taken, where necessary.</p> <p>2 Provide to AWSS, a checklist for determining if a lease is a capital or operating lease. (Completed)</p> <p>3 Review lease contracts as referred by AWSS, determine if the lease is a capital or operating lease. If it is a capital lease, then compute the lease values and provide necessary information for capitalized leased acquisitions for input into INOMS and PATS.</p> <p>4 Generate a yearly list identifying "major system acquisitions" based on prior, current, and projected implementation costs. This information will be derived from the Automated Financial System (AFS) based on PCAS codes and budgeted projections. This list will be shared with the Office of the CIO for review. (Completed)</p> <p>5 Identify and record all capitalized leasehold improvements.</p> <p>6 Draft an IRS-wide policy statement for signature by the Deputy Commissioner for Operations stressing the importance of assigning proper accounting strips to all acquisitions, especially related to the correct SOC and PCAS codes. (Completed)</p> |

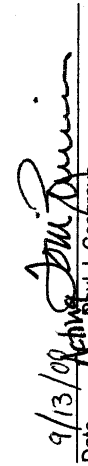
The Asset Management Program Can Be Successful Through Active Executive Monitoring and Oversight

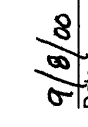
MEMORANDUM OF UNDERSTANDING CAPITALIZED PROPERTY AND EQUIPMENT TRACKING - OFFICE RESPONSIBILITIES SEPTEMBER 8, 2000


| Agency Wide Shared Services (AWSS) | Chief Information Officer (CIO) | Chief Financial Officer (CFO) |
|---|---------------------------------|---|
| <p>5 Initiate a policy under which Contracting Officers determine if proposed leases are capital or operating leases (see CFO-3). If the lease is a capital lease or if the Contracting Officer is unable to determine, then route the lease agreement through the Office of the CFO. Capital leases, in addition to meeting the criteria identified by the CFO, must have total payments over the life of the lease that exceed \$50,000. (Completed)</p> <p>6 Ensure that Facilities Management personnel notify ADP and Non-ADP Inventory Coordinators of the disposition of excess property in a timely manner consistent with current policies.</p> <p>7 Ensure capital asset disposal dates and codes are properly entered by the PATS Coordinators.</p> <p>8 Delete all TIGTA assets from the PATS system and ensure that future TIGTA acquisitions are no longer entered in PATS.</p> | | <p>7 In cooperation with the Office of the Chief Information Officer, develop and implement a methodology for identifying and capitalizing expenditures for internal use software, in accordance with the Standard of Federal Financial Accounting Standard #10, for implementation on October 1, 2000.</p> <p>8 Review all IRS capitalization policies and, when necessary, issue new policies to address the definition, capitalization threshold, useful life, and accounting treatment of all of the Service's Capital Assets. Make all property policies available to the Director of Agency-Wide Shared Services and the CIO. Such as the capitalization threshold for non-ADP property has currently been lowered to \$5,000 from \$50,000. However, as mentioned above, the IRS is reviewing its policies and may revert back to the Treasury Department threshold of \$50,000 if deemed appropriate.</p> <p>9 Explore the feasibility of using electronic invoice transfers.</p> <p>10 Determine which common data field will be used to systemically link the Request Tracking System (RTS), Automated Financial System (AFS), and Integrated Network and Operations Management System (INOMS). Completed</p> |

Concurrence:


 William E. Boswell
 Chief, Agency-Wide Shared Services


 Raul J. Cosgraves
 Chief Information Officer


 Lawrence W. Rogers
 Acting Chief Financial Officer


 Lawrence W. Rogers
 Acting Chief Financial Officer